TESTIMONY

OF

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ON BEHALF OF

Constellation Energy®
Commodities Group

AND

Constellation
NewEnergy®

HB 5520, HB 5521, HB 5522, HB 5523, HB 5524

MICHIGAN HOUSE ENERGY AND TECHNOLOGY COMMITTEE

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Executive Summary

- Customers who participated in Michigan's electric choice program have saved in excess of $500 million since inception of electric competition.

- Over two billion dollars has been invested in new generation by merchant generators, risking their own capital, and not saddling the ratepayers of Michigan with long-term mortgage payments.

- Over one billion dollars has been invested in the transmission system since passage of Public Act 141.

- DTE Energy and Consumers Energy have pressured lawmakers to repeal Public Act 141 each year since 2004.

  - Each attempt to eliminate choices for consumers and raise electricity rates has been met with huge resistance mounted by the very broad based Customer Choice Coalition, comprised of industrial, commercial and residential customers who have enjoyed the benefits of a competitive marketplace and do not wish to lose the benefits they have gained.

  - This coalition includes such members as the primary, secondary, and higher education public and private schools, hospitals, religious organizations, and many commercial and industrial associations.

- Michigan's customers were recently reminded why they defend competitive markets, when Consumers Energy offered to build a new coal fired power plant in exchange for repealing the restructuring laws. From May until September of this year, the cost estimate for the proposed generating facility increased by 42 percent without a shovel being turned.

- Without reliance upon a competitive market model, Michigan will not be able to achieve any meaningful targets associated with the development of renewable resources and advanced energy technologies, demand response, or energy efficiency.

- The proposed legislation will:
  - **provide Michigan's incumbent utilities with the ability to unilaterally increase rates 90 days after filing for a request to increase rates.** The utilities will also be allowed to file a new rate request nine months later regardless of whether the Commission has acted on the original rate request. This process will guarantee that the Commission will never be in a position to lower a utility rate increase request since the utility can simple file a new request and unilaterally increase rates 90 days later.
  - **legislatively mandate an increase in residential rates through the elimination of interclass rate subsidies.** While the elimination of interclass subsidies is a laudable goal, the legislature should be aware that residential rates will increase substantially under this proposal.
  - **eliminate the ability of the Michigan Public Service Commission to protect customers from cost-overruns and the inefficient operation of new, utility-owned generating facilities.**
  - **limit the Commission's ability to oversee the sale or transfer of generating assets owned by the State's incumbent electric utilities.**
  - **eliminate a customer's ability to choose an alternative electric supplier for its energy needs.** While the proposed legislation permits a one-time election, it is very likely that no alternative electric suppliers will remain in the constrained Michigan market.

Prepared Testimony of Terry S. Harvill, Ph.D.

Good morning Chairman Accavitti, Members of the Committee. Thank you for the opportunity to testify regarding House Bills 5520 through 5525.

My name is Terry S. Harvill, and I am the Vice President and Director, Retail Energy Policy for Constellation Energy.

Description of Constellation

Constellation Energy is a FORTUNE 125 company that is the largest competitive supplier of electricity, natural gas and energy-related services to commercial, industrial, and institutional customers throughout North America.

Constellation NewEnergy is the brand name under which Constellation sells electricity, natural gas and energy-related services to two-thirds of the Fortune 100 companies throughout the United States and Canada. CNE is a licensed retail supplier in 17 states, including Michigan, and two Canadian provinces and currently provides over 15,000 MWs of electrical supply directly to businesses throughout the North America. CNE is also the largest alternative electric supplier in Michigan and provides service to hundreds of electric and natural gas customers including many schools, commercial and industrial business. Constellation NewEnergy has maintained an office in Southfield since the introduction of competition in 2000.

Constellation Energy Commodities Group is a wholesale supplier of electric power to many of the nation's electric utilities in connection with either their standard offer or default service obligations and is one of the largest load-serving entities in North America.

Background

I received a Bachelor of Science degree and a Master of Science degree in Economics from Illinois State University in 1991 and 1992, respectively. I received my Ph.D. in Economics from the University of Illinois at Chicago in December 2007.

In 1998, I was appointed by then-Illinois Governor Jim Edgar to the Illinois Commerce Commission ("ICC"). The ICC is the State of Illinois' public utility commission that regulates electric, natural gas, water, and telephone utilities operating within the State of Illinois. During my tenure on the ICC, I served as the Chairman of the Commission's Electric Policy Committee. I served as a Commissioner until the expiration of my term in January of 2003. During that period, I and the other ICC Commissioners were very heavily involved in the implementation of the "Illinois Electric Service Customer Choice and Rate Relief Law of 1997."

I have approximately 15 years of professional experience in the energy industry, including serving as then Illinois Governor Jim Edgar's Assistant for Business and Economic Development. In that capacity, I was responsible for the development and implementation of the Governor's economic development strategy. In addition, I provided legislative analysis and guidance to the Governor on a wide variety of issues associated with business and economic development and regulatory policy and operations. I was responsible for electric, natural gas, and telecommunications restructuring/deregulation legislative efforts at both the state and federal level.

In 2003, I assumed the position of Director of Regulatory Affairs for DTE Energy in Detroit, Michigan. In this capacity, I was responsible for federal regulatory issues and various state regulatory issues. In January of 2006, I assumed the position of Vice President, Regional Regulatory and Government Affairs for Constellation NewEnergy, Inc. I have testified on various regulatory matters before the Illinois Commerce Commission, the Michigan Public Service Commission, the Maryland Public Service Commission, the Federal Energy Regulatory Commission, the Illinois General Assembly, the Ohio General Assembly, the United States House of Representatives Committee on the Judiciary, and the United States Senate Committee on Energy and Natural Resources.

Introduction

Today, based upon the bills before this Committee – Michigan stands at a crossroads:

Embrace customer choice and competition, or retreat to a system of government controlled monopoly regulation.

Competition has been the driving force of our Nation and this state for more than 200 years. I strongly urge this committee to take the steps necessary to move toward a competitive electric market that will best ensure choices, new jobs and innovation for Michigan.

Proposed Energy Legislation

HB 5520 – Sale of Power Plants

House Bill 5520 allows utilities to sell their existing power plants without restriction and restricts the Commission's disapproval to cases where electric choice is repealed and a material adverse effect on rates or the utility is found.

HB 5521 – Certificate of Need

House Bill 5521 addresses the review of need for new power plant and the Commission's prior approval of a proposal to build a power plant.

- Under this proposed legislation, only utilities could own or operate power plants.
- Any cost overruns are presumed reasonable if evidence is merely presented to justify the increase.
- The legislation also incorporates customer funding during power plant construction and shifts all risk of cost overruns to customers.

HB 5522 – Rate De-Skewing

This proposed legislation requires the Commission to set utility rates based on a cost-of-service basis previously disapproved by the Commission.

- Given the current rate cases pending before the MPSC, the effect of this legislation would increase residential rates by more than $350 million.

HB 5523 – File and Use

House Bill 5523 would allow utility rate increase requests to take effect automatically 90 days after filing by a utility without Commission approval.

- This automatic increase is much different then the current PSCR process whereby the Commission can hold a hearing and reduce the requested increase prior to it becoming effective.
- It is also important to recognize that under current law, a utility can request interim rate relief from the Commission if the Commission determines that an interim increase is warranted by the facts presented by the utility. The most recent example is the interim increase in rates granted by the Commission on Tuesday, December 18th, when the Commission increased Consumers Energy's rates by $70 million to account for the acquisition of the Zeeland generating facility.
- The traditional rate case would proceed to a final Order of the Commission and then retroactively adjust the rates put into effect automatically by the utility.
- Meanwhile, new rate increase requests can be filed by the utility nine months after existing increases were implemented even though the preceding case may not have been completed.
- With rate request after rate request stacked on top of each other, the Commission would never be in a position to reduce rates to consumers.
- For example, a utility requests an increase of $200 million. Ninety days later the utility increases rates unilaterally by $200 million. In nine months, the Commission is prepared to reduce rates by $100 million after completion of their investigation and hearings. On the day the Commission enters a final Order to reduce rates by $100 million, the utility can file for another increase of $100 million (or more) thereby negating the effect of the Commission's Order to reduce rates.

HB 5524 – Virtual Repeal of Public Act 141

House Bill 5524 contains severe limitation on electric choice by incorporating a one-time election within 90 days of enactment between service from an alternative electric supplier or the incumbent electric utility.

- Electric choice customers returning to bundled rates would be charged market rates for one year except where the customer certified that their electric choice contract predated the legislation.
- The proposed legislation also allows Consumers Energy to charge all customers for over $60 million of stranded costs.
- Alternative electric suppliers would likely leave the Michigan market since the number of customers to serve could only decrease over time.

<u>Competition Is Working Well and Delivering Benefits to All Consumers</u>

Understandably, policymakers are quite concerned about ensuring reasonably priced and reliable electricity for consumers. However, electric rates are rising across the country and Michigan is not immune from that fact. These increases are largely due to rising fuel costs due to the global demand for fossil fuels, recent severe hurricanes, and reliance upon foreign resources to meet domestic demands. Also important is cost increases are being felt by customers in regulated and restructured states at virtually the same rate -- roughly 34% since 1999.

States that have not restructured and do not allow customer choice have been hit with much higher costs as well -- often in the form of an automatic increase on their bill. In these states, steady increases over a number of years have been passed through to consumers. Compounding this risk is the unbridled discretion provided to the electric utilities to increase rates under House Bill 5523.

Competition will keep costs as low as possible and produce the benefits customers and policymakers are seeking across the United States:

- Advancements in reliability, conservation, renewable energy development, and the ability of customers to purchase green power products. With growing concerns regarding global warming there is a market for conscientious consumers who wish to use only renewable green energy for their business or home. By protecting retail choice we let individual consumers help Michigan reach the State's renewable goals.

- A significantly better platform to promote demand response and energy efficiency than traditional cost-of-service regulation. Demand response refers to mechanisms that provide the tools and incentives for electricity customers to reduce their consumption at critical times or in response to market prices. In cases where consumers do not pay actual market prices, they have little or no incentive to reduce consumption (or defer consumption to later periods) during times when production costs are significantly higher. Since costs may be substantially higher at these times, the potential for savings should not be overlooked.

- The ability and information to make decisions and have choices regarding their electric power needs – just as they do with telecommunications, natural gas, airlines which were previously regulated under a monopoly system of regulation.

Solid research demonstrates that well-run competitive markets far outperform monopoly regulation when measured by these metrics. Residential, commercial, governmental, and industrial customers will all suffer if Michigan charts a course that returns us to the old monopolistic system, which brought inefficiency, wasted resources, unreliable power supplies, and pollution.

It Is Important to Separate Fact From Fiction In This Current Debate

One area where the public record and public discourse needs to be updated and corrected is regarding a number of unsubstantiated assertions regarding competition, competitive markets, and some of the issues advanced by the proponents of House Bills 5520 through 5525.

The most significant myth that should be dispelled is whether competitive markets can and are working in the delivery of electricity. It has been directly and indirectly implied that they are not and cannot. The reality is that they can and are working and are delivering tangible benefits to customers across the country. Competition uses the drivers of innovation, efficiency, and entrepreneurialism, not bureaucratic regulatory oversight, to produce results. Michigan has certainly embraced measures to advance competition in the natural gas and telecommunications industries and should do so with electricity. Effectively competing is how virtually all industries operate, and this should be no different in the provision of electricity.

There are various other myths and fictions that have been fostered by opponents of competition and proponents of House Bills5520 through 5525, including:

- *Competitive wholesale energy markets have led to higher retail prices*

  Numerous independent studies have shown that wholesale competition has reduced costs for millions of retail energy consumers. Rate increases can be attributed to the cost of natural gas-the primary fuel for many generators and, in some parts of the country, for most generators. Like the price of other fossil fuels, the price of natural gas has more than doubled since 2001. Importantly, this increase in fuel costs would have had a greater impact on retail prices under the old, regulated monopoly system. Economists Howard Axelrod and David DeRamus recently wrote that without wholesale competition, energy prices would have been up to 15 percent higher in many markets. In fact, according to a November 2006 *Public Utilities Fortnightly* article written by leading energy economists, retail customers in many regulated states have experienced steady increases over a number of years, often in the form of automatic rate increases. These regular, smaller price hikes can add up to a large percentage increase over time. Between 2000-2005, electricity rates increased 43% in Colorado, 46.7% in Oklahoma, 53% in Mississippi, and 67.3% in Louisiana. In many restructured markets, including Michigan, electricity rates were capped and kept artificially low for many years, leading in some instances to larger increases when caps were ultimately removed. You have probably read or heard previous testimony describing how electric prices in states whose industries are still regulated are lower than prices in states that restructured their electric industry, like Michigan, and that this "proves" restructuring has failed. While this "proof" may make for a good headline, it is economic nonsense. Restructuring took place in states whose electric rates were highest because the perceived savings from paying the average cost of electricity to paying those tantalizingly low prices that low natural gas prices and highly efficient combined-cycle plants offered were the largest. Why would states like Washington and Idaho, with their vast quantities of low-cost hydroelectric power, much of it from plants built by the U.S. Government decades ago, want to open their markets up?

- *Only the largest customers benefit from competition.*

A 2005 study by Cambridge Energy Research Associates found that wholesale competition resulted in $34 billion in savings for residential customers across the country over seven years, compared to what would have been paid under traditional regulation.

- *Reliability has suffered or deteriorated due to competition.*

Since energy restructuring created open, competitive wholesale markets in many parts of the country, reliability was enhanced through the Midwest Independent System Operator and PJM and operation of large wholesale markets. In addition, tens of billions of dollars in new transmission projects have been approved in those restructured regions. Further, the transmission and distribution systems remain a monopoly-regulated system under the regulation of the PUCO.

- *The blackout of 2003 was a direct result of competition and restructuring.*

The Joint FERC/DOE and Canadian Task Force that was charged with investigating the blackout issued a detailed and lengthy report. It found that ultimately, it was a vegetation management problem that caused the blackout, and that had nothing to do with restructuring. In fact the vegetation management problem, which was ground zero for the blackout, was in the service territory of a vertically integrated utility, operating in a vertically integrated fashion. Reliability has improved markedly since open access regional wholesale markets have begun to operate, and fact documented in study after study and testified to by market participants. The Michigan Public Service Commission also conducted an independent study and confirmed that the blackout was not "made in Michigan" and was not related to Public Act 141.

- *Competitive suppliers are not interested in serving customers in Michigan.*

There are over 20 valid licensed competitive suppliers in the state. Most of these suppliers as well as the trade associations that represent the interests of retail and wholesale suppliers are members of the Customer Choice Coalition and are actively

engaged in this debate, and eager to serve Michigan customers in a market structure that allows for fair and open competition. Competitive suppliers will provide innovative services and technology, and will make investments in Michigan if it truly open the doors to competition.

Reviewing some examples of what is occurring in a number of other states can be helpful in dispelling some negative myths concerning competitive electricity markets.

- In **Illinois**, 20 certified suppliers are licensed to provide service to customers and 15 are actively serving small and medium sized businesses. During the seven year transition period, business customers who took advantage of choice saved approximately $1.3 billion, and residential customers saved in excess of $1 billion. **Despite the legislative debate that ensued after the end of the 10-year rate freeze and 20% rate reduction, the General Assembly solidified its commitment to retail competition as the best means to serve customers over the long-term. Contrary to unsupported assertions before this Committee, Illinois did not "re-regulate" but merely altered the manner in which utility default rates are to be set. Again, despite assertions to the contrary, those rates are still set via use of a competitive wholesale procurement process. Currently, over 65 percent of all ComEd load has switched to take advantage of the offer of a competitive supplier, with 93 percent of all accounts over 1MW making the move. Large customers in the Ameren service territory have also been taking advantage of competitive offerings, with 98 percent of larger customers taking competitive service and nearly 9,000 customers who have load of under 1MW taking advantage of a competitive offering.** As with Pennsylvania, the generating fleet in Illinois has responded to the pressures of competition by showing dramatic efficiency and productivity improvements. Finally, similar to the experience in other states, independent power producers constructed more than 9,000 MW of new, cleaner, more energy efficient generating facilities.

- In **New York**, 625,000 customers or 11 percent of residential consumers are purchasing their energy from competitive suppliers, with the state seeing a growth rate of some 55 percent in just one year. In one utility service area, residential customers have 37 rate offerings from competitive suppliers, green power providers and the local utility. In aggregate, 41 percent of total electricity usage in New York is provided by competitive suppliers. Among commercial and industrial customers, 56 percent of customers and 77 percent of load has switched to competitive suppliers. Electricity rates actually fell by 9.2 percent from 2004 to 2006.

- In **Texas**, the market is maturing daily, bringing lower prices, new products and more choices to consumers. Approximately 40 percent of residential customers have switched to a competitive retail electric provider since customer choice began in 2002 and an additional 27 percent have switched to competitive rate plans offered by the incumbent utility. In some areas of Texas, residential customers have approximately 90 products and services from which to choose. In a number of cities, competitive rate offerings are lower than the last regulated rate charged to residential customers prior to the opening of the market. These lower prices exist even though the price of the dominant fuel source in the state has increased threefold.

- In **Pennsylvania**, consumers are paying 12 percent less for electricity today than they were paying in 1996 (inflation adjusted dollars). Competition driven efficiency gains have also been the result of restructuring. Cleaner nuclear power plants are generating 1.7 million MW/h more electricity than they produced a decade ago, yielding a monetized benefit of between $50 million and $130 million annually for Pennsylvania's customers. Investment in new generating capacity was encouraged by the state's move to a restructured market. Capacity was increased by more than 23 percent between 1998 and 2005 while demand only increased by 15 percent. These more than 9,000 MW on new capacity included many renewable and wind farm resources. Finally, the price differentials between Pennsylvania and its neighboring states that did not restructure have improved dramatically in favor of Pennsylvania. From 1998 through 2005, electric rates increased by 13 percent in non-restructured neighbors, but by just 5.6 percent in Pennsylvania.

Getting Needed Investment in Competitive Markets

One of the most fundamental tests of a well functioning market is whether it is attracting investment in needed infrastructure. Despite rising prices and declining reserve margins, there is increasing concern that needed investment in transmission, generation and demand response is not being made in today's competitive markets. In Michigan, these concerns have led to calls for re-regulation of electricity markets by DTE Energy and Consumers Energy, with wholesale and retail competition being replaced by a return to a cost-of-service based investment in facilities owned and operated by vertically integrated utilities. However, there are legitimate reasons that investment has slowed, and there are better solutions than a return to the not-so-good "good old days."

Can Competitive Markets Attract Investment?

Despite conventional wisdom to the contrary, the facts show the answer is a resounding "yes." Competitive markets have produced significant new investment, particularly in newer, cleaner generation technology and in transmission infrastructure.

Nationwide, between 1993 and 2003, competitive power suppliers added more than 187,000 megawatts of new generation capacity to the nation's energy supply.

- In New England, almost 10,000 megawatts were added in the first six years of market restructuring, adding almost 30 percent to the generation supply.

- In New York, over 4,000 megawatts of new generation has come on line since the New York ISO was created.

- In PJM over 150 new generation projects have been brought on line since 1999, totaling more than 19,000 megawatts of capacity. Another 3,500 megawatts of new capacity is under construction. Over 1,100 megawatts of that new capacity has been wind and other renewables.

- In Pennsylvania alone, over 9,000 megawatts have been added, including eight wind farms totaling 180 megawatts. Last week, Constellation Energy announced an agreement with Conectiv Energy to purchase 545 megawatts (MW) of electric power to be produced at a new combined cycle natural gas plant to be developed in York County, Pennsylvania.

- In Texas, almost 20,000 megawatts of new generation has been announced, including 7,700 megawatts of new coal, of which 750 megawatts is already under construction, and 4,700 megawatts of new nuclear power.

- In addition, states that have restructured, or participate in organized markets, have seen significant increases in renewable generation compared with traditionally-regulated states. According to EIA, net renewable generation in restructured states increased by over 11 percent between 2000 and 2005, while there was a less than one percent increase in renewable generation in traditionally-regulated states.

Competition has also brought significant operating improvements in existing technology. Nuclear power plants in areas with organized regional markets have improved their average capacity factor from 66% to 92%, compared with plants in other areas that improved their average capacity factors from 74.5% to 88.4%. Nationwide, three fewer nuclear plants produced almost 150 million more megawatt hours in 2006 than in 1994. Similarly, the capacity factor at coal plants has improved 16%, making an additional 50,000 megawatts of capacity available. And despite allegations that transmission investment is lagging in the organized markets, PJM has made significant investment in the region's transmission network. Since the first Regional Transmission Expansion Plan was adopted in 2000, PJM has invested over $683 million, with an additional $638 million in transmission upgrades under construction. Over $4.2 billion in additional transmission projects are currently planned in PJM.

What Is Slowing Investment Today?

So what is prompting today's concerns that competitive markets are not providing the incentives necessary for new infrastructure investment? Since the mid-1990s, most of the nation has had a significant amount of excess generation capacity. While some areas have experienced tighter supplies, on a regional basis, reserve margins have been far above the amounts needed to assure reliability. However, as reserve margins have declined, some policy makers have expressed concern that markets alone don't appear to be responding with infrastructure that will assure adequate reliability.

The decision to make large long-term investment in electricity infrastructure in a competitive market is driven fundamentally by price signals. Electric industry market design is fraught with the unintended consequences of policy choices that have compromised price signals that would otherwise provide the incentives for needed investment. Before crafting a "solution," it is important for policymakers to fully understand all of the decision-drivers and how they interact.

- **Price Signals**: In competitive markets, investment decisions are driven by price signals. Unfortunately, in today's wholesale markets, price signals are often muted by mitigation measures and out-of-merit dispatch. In PJM, for example, the State of the Market Report has concluded that, since 1999, revenues available to generators are not sufficient to recover the costs associated with new investment. This may be the right outcome when PJM has excess generation to meet its reliability needs but is problematic when market design choices continue to control prices at artificially low levels, even as supply and demand fundamentals show a need for new generation. When this occurs, incentives for efficiency and demand response, as well as new investment, are lacking, even as reliability concerns emerge. Policymakers also need to recognize that in a well-functioning market where buyers are also sellers (managing the risks associated with natural price swings), there is little long-term incentive to drive prices to artificially high levels.

- **Capacity Markets**: There has been a growing concern that capacity markets in organized markets – the mechanism intended to make up for the impact of bid caps and other mitigation measures that blunt energy price signals – are not working as intended, particularly with respect to locational capacity needs. To address concerns about capacity market design shortcomings, ISO-New England and PJM have proposed locational capacity programs, a feature already embedded in the New York ISO capacity market. After extensive settlement discussions, FERC recently approved both the ISO-New England and PJM locational capacity plans. Both are in initial implementation phases, and both are showing significant promise in attracting needed investment in both generation and demand response. ISO-New England recently released its 2007 Regional System Plan, announcing more than 10,500 megawatts of new generation in the pipeline, together with 1,200 megawatts of demand response, largely in response to its new Forward Capacity Market. In response to PJM's Reliability Pricing Model, an additional 2,500 megawatts of new generation has been added, as well as almost 900 megawatts of demand response. Reliant Energy, Constellation and PSEG have all announced plans to keep existing generation on line or new generation projects in response to the new PJM capacity market.

- **Environmental Uncertainty**: A significant factor in slowing generation investment is the uncertainty over the future of environmental regulation of greenhouse gas emissions. As a nation, we are increasingly concerned about slowing, stopping and, ultimately reversing, greenhouse gas emissions from power plants. However, uncertainty about emission limitations, carbon cost and untested technologies are slowing investment decisions until more questions are resolved.

- **Siting Concerns**: Another significant concern slowing investment in both generation and transmission are the issues associated with siting needed infrastructure. Congress recently granted FERC backstop siting authority for new interstate transmission facilities, tied to DOE's designation of National Interest Electric Transmission Corridors. DOE's recent announcement of proposed corridors has sparked a new Congressional debate about repealing that aspect of the 2005 Energy Policy Act. Some generation projects, such as wind or hydro, can only be built where the resource is available, while others, such as coal or nuclear, need to be built away from population centers, thus necessitating transmission facilities. While community involvement is crucial to successful infrastructure investment, the ability of opponents to tie up projects in endless and expensive litigation is a "yellow light" for some projects.

- **Regulatory Uncertainty**: While policy makers and regulators need to monitor markets assuring that public policy goals are met, generation and transmission are long lead time projects that remain in place for decades. Developers and financiers need to have confidence that stable market rules will remain in place so that their investment decisions will not be undermined by changing regulatory policies such as calls for re-regulation, windfall profit taxes, extended price caps and legal threats to contract sanctity, all of which can undermine investor confidence.

Solutions

As we face the prospect of investing billions of dollars in new infrastructure in Michigan, it is incumbent on policy makers to recognize that one of the most important aspects of the move to more competitive markets was the transfer of risk for new investment from captive utility ratepayers to wholesale generators and suppliers who are better able to manage those risks. While it is true that some of those that developed competitive generation in the mid-1990s ended up in bankruptcy, however, the megawatts built or bought by these companies continued to serve customers, and it was the shareholders of those companies, rather than the captive ratepayers of a utility, who paid for the investments. As we face the next round of investment decisions, policy-makers should focus on promoting well-functioning competitive markets that allow developers to analyze and manage investment risks and customers to benefit from having multiple suppliers competing to serve load. To promote needed investment in generation, transmission and demand response, policy makers should focus on:

- **Accurate Price Signals**: At the heart of all investment decisions is a basic understanding of supply and demand fundamentals and price signals that reliably and accurately reflect the supply and demand balance. Without accurate price signals, investment will not be made in generation, transmission or demand response. Of course, having accurate price signals in the wholesale market does not mean that all customers, particularly smaller commercial and residential customers, need to see high and/or volatile prices. At the retail level, state commissions can put in place competitive procurement programs to manage the risk associated with spot market volatility. While many larger commercial and industrial customers are well suited to manage their energy portfolios, many smaller customers are best served through a standard offer service, where wholesale suppliers compete to procure the supplies needed to serve those customers and which result in fixed-price contracts. This will allow smaller customers to not only better manage costs but make it easier to compare multiple types of offers from competitive retail suppliers. Moreover, accurate price signals do not mean maximum profitability for generators. A price signal is a snap shot of the current to mid-term financial environment. An accurate price signal provides investors with necessary information as they accept the risk of billion dollar investments, but it does not guarantee or lock in profits. Generation investment has often had building booms that ended badly for companies that invested poorly. Accurate wholesale price signals, over a sustainable period, allow suppliers to determine when investment in new facilities and/or demand response measures are the most cost-effective way to serve load.

- **Capacity Markets**: In response to concerns about pervasive mitigation in organized markets, RTOs have developed, and FERC has approved, locational capacity markets designed to promote investment when and where needed. These capacity markets need time to mature and function before "fall-back" programs are considered.

- **Simplified Siting, Permitting and Taxing Authority**: An important step states can take to promote generation investment is to simplify and streamline siting, permitting and taxing authority within their state. One-stop shopping for all necessary environmental permits, a limited appeal process, making available priority sites for new facilities, and favorable tax treatment for generation investment are a few of the things states can do to promote investment within their jurisdiction.

- **Regulatory Certainty**: To encourage long-term investment, policy makers need to work together to create a stable regulatory climate for investment. Parties need to know that their investment decisions will be devalued by a continually changing regulatory landscape.

The issues facing policymakers and the industry over the next several years require a complex balancing of many competing interests. While reliability and resource adequacy must be assured, compliance with new environmental requirements, advancement of new technologies, promoting of renewable energy, demand response and energy efficiency will require a thoughtful approach to meeting America's 21st century energy challenges.

<u>Competitive Suppliers Are Leaders In The Development of Renewable Resources</u>

Total installed wind capacity has dramatically increased over the past several years largely due to the investment by competitive suppliers. According to the U.S. Department of Energy, 71 percent of new wind capacity in 2006 was built by independent power producers. In addition, 85% of total wind capacity is owned by competitive suppliers. What this means is that captive ratepayers are not responsible for these costs. Instead, competitive suppliers and their shareholders ear these risks. A recent Report issued by the ISO/RTO Council, the organization that represents the 10 Independent System Operators and Regional Transmission Organizations in North America found the following:

- Renewable resources, including hydroelectric generation, currently supply about 9% of the electric energy provided by North America's [ISOs] and [RTOs].... The markets supported by the ISOs and RTOs have proven to be fertile ground for the development of renewable resources." (*Increasing Renewable Resources: How ISOs and RTOs Are Helping Meet This Public Policy Objective*, ISO/RTO Council, October 16, 2007, p. ES-1)

- "The success of markets in enabling renewable resources is evidenced by the fact that ISOs and RTOs host 79% of today's installed wind generation, which is well above their 44% share of wind energy potential and 53% share of total North American electricity demand." (p. ES-2)

- "Renewable generators account for 142,171 [MW] of the 326,459 MW of generation in the ISO and RTO interconnection queues. ...[W]ind generation is the largest proposed generation technology in the ISO and RTO queues, totaling 124,012 MW. This exceeds natural gas (89,579 MW), is more than double that of coal (55,667 MW), and is nearly four times that of nuclear (36,047 MW). Wind accounts for 87% of the renewable generation in the ISO and RTO queues." (p. ES-2)

- "Four features of these wholesale electricity markets play an especially critical role in developing renewable resources.... These features are enhanced by the open governance process of ISOs and RTOs, which includes extensive stakeholder input in establishing market rules and can quickly respond to the needs of new technologies. (p. ES-2,3)

  - "First, large, organized markets in ISO and RTO regions are open to all those interested in investing and building new power plants.
  - Second, the price transparency of these markets lets developers know the value of their power, making investment decisions easier.
  - Third, the five- to fifteen-minute dispatch of these large markets and the large size of these markets reduce the cost of integrating wind into the power system by taking advantage of wind diversity and the ramping capability of conventional generators.
  - Fourth, coordination of regional transmission planning makes it possible to build the transmission needed to bring renewable energy to market."

- Of the 25 states and the District of Columbia with [Renewable Portfolio Standards], 17 are served at least partially by an ISO or RTO.... ISOs and RTOs play an important role in the implementation of Renewable Portfolio Standards. Most prominently, they help with tracking generation, RECS [Renewable Energy Credits], or both because ISOs and RTOs have the generation and load data necessary to measure [RPS] compliance." (p. 8)

Constellation's Commitment to Sustainability Initiatives

Constellation has a strong commitment to renewable energy initiatives and sustainable energy policies. The following are some recent items that we would like to highlight to the Committee:

- **Constellation Energy Receives 2007 Green Power Leadership Award** – On October 24, 2007, Constellation received a 2007 Green Power Leadership award from the U.S Department of Energy (DOE) for successfully incorporating green power into the overall energy portfolio for the Washington Suburban Sanitary Commission (WSSC), the eighth largest water and wastewater utility in the nation. The DOE's annual awards recognize leading national green power suppliers for their commitment and contribution to helping advance the development of the nation's green power market. In addition to incorporating the most efficient demand-side technology and supply-side purchasing strategies into their energy portfolio, Constellation Energy's innovative approach included working with Edison Mission Group to build a 30 megawatt (MW) wind power project, which will provide 85 percent of its power to WSSC. The new wind facility is financed through a 10-year power purchase agreement. Beginning January 2008, WSSC will receive 85 percent of the wind project's power, and renewable energy credits (REC) output, representing approximately a 70,000 MWh annual wind purchase, and serving 33 percent of the overall electricity needs of the WSSC facilities.

- **Constellation NewEnergy and HMSHost Corporation Sign Renewable Energy Agreement** – On October 16, 2007, Constellation NewEnergy announced an agreement with HMSHost Corporation here Constellation NewEnergy will secure approximately six million kilowatt hours of Green-e certified Renewable Energy Credits (RECs) to match 50 percent of the electricity used at the company's three travel plazas located along Interstate 95 in Delaware and Maryland. A combined 13.5 million customers visit the Chesapeake, Maryland and Delaware House plazas annually. The RECs will directly support the operation of clean, renewable wind generation; helping avoid the carbon emissions produced from the combustion of fossil fuels.

- **Constellation NewEnergy and Jurys Boston Hotel Agree to Match Electricity Usage with 100 Percent Renewable Energy** – On October 4, 2007 Constellation NewEnergy and Jurys Boston Hotel announced an agreement under which Constellation NewEnergy will provide approximately 7 million kilowatt hours of Green-e certified Renewable Energy Credits (RECs) for 100 percent of the hotel's electricity usage, making Jurys one of the first hotels in Boston to match its entire load with green energy sources. Winner of the First Annual City of Boston Green Business Awards 2007 for "Green Business Practices," and named an "Energy Star Hotel" in 2006 by the EPA, Jurys' decision to match 100 percent of its electricity usage with RECs complements a number of other sustainability initiatives.

- **Constellation Energy Enters Power Purchase Agreement with Horizon Wind Energy Twin Groves Project** – In July and October of 2007, Constellation Energy Commodities Group, Inc., signed an agreement with Horizon Wind Energy, a company owned by Energias de Portugal (EDP), for power produced at the Twin Groves wind farm outside of Bloomington, Ill. When Phase II is completed, Twin Groves will have 240 turbines and produce almost 400 MWs of power making it the largest wind farm east of the Mississippi River. Two agreements are each 18 years in length and run through 2025. The Twin Groves wind farm is located in eastern McLean County, Ill., and interconnected to the regional PJM interconnection power grid.

- **Constellation NewEnergy to Match Wind Power for Electricity Usage at Sustainable Brands Conference** – On September 28, 2007 Constellation NewEnergy announced an agreement to supply 250,000 kilowatt hours of Green-e Certified Renewable Energy Certificates (RECs) to match 100 percent of the electricity usage during the Sustainable Brands '07 Conference in New Orleans. The RECs, which have been secured for the duration of the three-day conference, supported the development of clean, renewable wind generation and avoid the carbon emissions produced from the combustion of fossil fuels. Sustainable Brands '07 brought together Fortune 500 companies and business leaders to discuss the importance of developing more environmentally-friendly and socially-responsible products and solutions.

- **Constellation Energy Senior Players Championship to be First PGA TOUR or Champions Tour Event Powered by 100 Percent Renewable Energy** – The late September Constellation Energy Senior Players Championship was the first-ever PGA TOUR or Champions Tour event to be powered fully by renewable energy. As the title sponsor of the final major championship of the season on the Champions Tour, Constellation Energy employed several strategies to ensure that all of the tournament's energy needs will be offset with clean, renewable energy. Constellation NewEnergy purchased an estimated 100 megawatt-hours of renewable energy credits to offset energy consumption at the clubhouse and used on-site bio-diesel generators to power all facilities throughout the course. In addition, all plastic and cardboard generated from course concessions and tournament materials were recycled. Additional on-site generation such as solar power was also used. The tournament expected to offset energy needs equal to approximately 100 megawatt-hours with renewable energy, while avoiding nearly 63.7 metric tons of carbon from entering the atmosphere.

- **Constellation NewEnergy to Match Geothermal Power for San Francisco Museum of Modern Art Environmental-Themed Exhibition** -- Constellation NewEnergy worked with the San Francisco Museum of Modern Art (SFMOMA) to ensure that its "Your tempo: Olafur Eliasson" exhibition is matched by regional geothermal energy. Constellation NewEnergy has secured green power for the duration of the exhibition (Sept. 8, 2007 through Jan. 13, 2008). With the exhibition exploring numerous environmental issues including global warming, SFMOMA wanted an energy partner to help reduce the exhibition's carbon footprint. Given SFMOMA's support of locally produced renewable power, Constellation NewEnergy was selected in part because of its ability to match the exhibit's electricity usage with energy generated by the Geysers Geothermal Facility located in Northern California. This clean energy purchase is the equivalent of avoiding the emissions from more than 100 barrels of oil.

- **Constellation NewEnergy Signs Renewable Energy Agreement with the City of Evanston, Illinois** – On February 8, 2007, Constellation NewEnergy entered into a green electricity purchase agreement with the city of Evanston, Ill. As part of the agreement, Constellation NewEnergy will secure approximately 5.5 million kilowatt-hours of Renewable Energy Credits (RECs) to offset 20 percent of the city's electricity usage. The secured RECs will help the city of Evanston replace the carbon emissions produced during the combustion of fossil fuels with clean, renewable wind generation. Constellation NewEnergy will serve the city's combined peak demand load of approximately 4,000 kilowatts (19 million kilowatt-hours annually), which is required to power several high-profile municipal facilities, including the Robert Crown Ice Arena, Evanston Art and Cultural Centers, the Ecology Center, the municipal water pumps and the city's parks and recreational facilities. The city of Evanston's decision to purchase RECs is another step in the city's ongoing efforts to pursue environmentally friendly solutions. In 2005, the city was promoted to Silver Status by Clean Air Counts, a Northeastern Illinois regional initiative to reduce greenhouse gas emissions. Evanston has also taken steps to replace city traffic lights with energy efficient bulbs, and power city vehicles with cleaner burning bio-diesel fuel. Based on a national average utility emissions rate, diversifying the city's electricity supplies with alternative fuel sources will keep more than 7.4 million pounds of carbon dioxide out of the atmosphere every year. That amount is equivalent to avoiding the CO_2 emissions produced by 300 passenger cars and is the same amount of electricity needed to power more than 500 average American homes annually.

- **Constellation Energy Wins Wind Power Agreement With Washington Suburban Sanitary Commission** – In December 2006, Constellation Energy was awarded a 10-year contract to provide wind power to the Washington Suburban Sanitary Commission (WSSC). The innovative 10-year agreement will meet WSSC's ambitious goal of using wind power for approximately one-third of its electricity needs. WSSC General Manager Andrew Brunhart said the agreement will lower the agency's energy expenditures by an estimated $20 million dollars over 10 years. Constellation Energy, through its subsidiary, Constellation Energy Projects & Services, has a long-established relationship with WSSC as energy consultant and risk manager.

- **Baxter Announces Carbon Neutral Headquarters** – On April 25, 2007, in a keynote address to nearly 600 attendees at the 2007 Ceres Conference in Boston, Baxter Chairman and Chief Executive Officer Robert L. Parkinson, Jr. announced that Baxter purchased Green-e certified renewable energy certificates from Constellation NewEnergy equivalent to the 15.5 million kilowatt hours of wind electricity used on an annual basis at its corporate headquarters campus located in Deerfield, Illinois. Baxter's headquarters campus in north suburban Chicago covers 100 acres, and includes

654,000 square feet of office space housing approximately 1,500 employees. Baxter's headquarters campus relies on electricity for 98% of its energy needs, which will be offset through the purchase of the renewable energy certificates. The combination of purchasing Green-e certified renewable energy certificates to offset 100% of the greenhouse gas emissions associated with the Deerfield campus' electricity use and offsetting the emissions associated with the facility's natural gas use creates what is known as a "carbon neutral" facility. Baxter's investments in alternative fuel sources through the purchase of renewable energy certificates on behalf of its headquarters campus will keep more than 11,600 tons of carbon dioxide out of the atmosphere on an annual basis. This amount is equivalent to the carbon dioxide emissions of 2,172 passenger cars per year, according to the U.S. Department of Energy. Baxter's purchase of 15.5 million kilowatt hours also equates to the amount of electricity needed to power more than 1,257 average American homes annually.

- **Constellation NewEnergy Wins Green Power Contracts With New York State Olympic Regional Development Authority** -- On March 29, 2007, Constellation NewEnergy announced a series of power supply contracts with the New York State Olympic Regional Development Authority (ORDA). Under the agreements, Constellation NewEnergy will provide a Green-e certified ElectricGreen(R) product to the existing supply of six megawatts of peak load to Gore Mountain, and begin to supply eight megawatts of peak load to Whiteface Mountain, both facilities within the ORDA. Ten percent of the non-production related electric load for both locations will be supplied through Constellation NewEnergy's Green-e certified ElectricGreen(R) product. Whiteface Mountain, located in Wilmington, NY, is unique in American winter resorts - a place of unrivaled history and uncommon skiing and riding. Gore Mountain, located in North Creek, NY, now offers five new additions to the trail map and covers an impressive 344 acres of skiing. The New York State Olympic Regional Development Authority was created by the State of New York to manage the facilities used during the 1980 Olympic Winter Games at Lake Placid. ORDA operates Whiteface Mountain and Gore Mountain ski areas; the Verizon Sports Complex, located 5 miles from Lake Placid at Mt. Van Hoevenberg; and the Olympic ice and jumping complexes. As host to international and national championships, the Authority has brought millions of athletes, spectators and visitors from around the globe to the Adirondack region.

- **Constellation NewEnergy Wins Green Power Supply Contract With City of Rochester, N.Y.** – On December 1, 2006, Constellation NewEnergy announced a two-year power supply contract with the City of Rochester, New York. Constellation NewEnergy will supply eight megawatts of peak load to the City of Rochester. Fifteen percent of the electric load will be supplied through Constellation NewEnergy's Green-e certified ElectricGreen(SM) product. The City of Rochester's City Hall will also be supplied by 100 percent green energy. The agreement with Constellation NewEnergy is expected to save the City of Rochester more than $450,000 over the contract period. The direct environmental impact of this partnership is the equivalent of removing 1,600 vehicles from the roads. It also promotes local economic development by using in-state resources and power plants, and increases American energy independence by reducing reliance on foreign energy sources.

- **Constellation NewEnergy Signs Long-Term Agreement with the City of Brockton, Mass. To Purchase Solar Energy** – In June 2006, Constellation NewEnergy announced that it won a long-term contract with the City of Brockton, Mass., in which the company will purchase all of the output from the City's new solar energy power plant. The agreement – one of several new contracts that Constellation NewEnergy has entered into for renewable generation projects – displays the growing demand for alternative energy sources and the heightened awareness around environmentally responsible power. Brockton's solar project is located on a former brownfields site, now appropriately called a "Brightfield" area. The project will be the first utility scale solar photovoltaic system in New England. Designed to produce 425 kilowatts of electricity, the Brightfield site will generate enough energy per year to power City Hall and a portion of the police station's load. Construction of the Brockton Brightfield site commenced on May 1, 2006. The proposed design incorporates the solar panel array into a park setting that will also feature educational displays and activities. Using electricity generated by Brockton's Brightfield will avoid the emission of about 595,300 pounds of carbon dioxide each year. That is the equivalent of taking 45 cars off the road, or the amount of carbon dioxide that would be absorbed by planting 89 acres of trees. The Brightfield project will also eliminate nearly 1,000 pounds of sulfur dioxide and 370 pounds of nitrogen oxide each year.

- The alternative energy companies that the Governor and legislators are working so hard to attract to Michigan will look to other state's with a less hostile and more stable regulatory environment.

- Customers, not utility shareholders, would return to being the guarantor for new power plant construction. Given the history of cost-overruns and inefficient operations by DTE Energy and Consumers Energy, why would Michigan chart a course to repeat the mistakes of the past?

- The reliance upon the competitive market place is the best means to achieve the widest possible deployment of renewable and advanced energy technologies at the lowest possible cost to consumers.

- A return to cost of service pricing would harm conservation, demand response, and innovation by hiding the actual cost of the electric power we use in Michigan.

Policymakers should recognize that government intervention, however well intentioned, cannot repeal the laws of supply and demand. This legislature and the Commission should work to expand the choices available to electricity customers, rather than imposing heavy-handed regulatory mandates that eliminate those choices. In addition, the legislature should act to provide a high degree of regulatory certainty. This might be the single most important goal for the legislature. There is a tremendous potential for new, innovative approaches to meet Michigan's electric needs. But if potential market entrants and their investors fear that the "rules will change" over and over, it becomes far too risky to invest scarce capital.

Finally, we urge you to continue to take a sufficient amount of time to analyze, study, and debate the very complex legal, policy, and factual issues associated with changes to Michigan's energy policy and regulation. These are decisions that can have major economic, social, legal, and environmental impacts for many years to come – decisions that are not simple to correct. By taking an organized and systematic approach to properly studying, analyzing, and debating these very complex and important issues, Michigan can avoid any long-term negative consequences for Michigan's electricity infrastructure, economy, environmental policies, and most importantly electric rates. Thank you for this opportunity to testify before you today.